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SENSITIVE

STATE FOR EAP/CM  
USDOC FOR ITA/IA/OP MICHAEL ROLLIN  
USDOC FOR 4420/ITA/MAC/CEA/MCQUEEN  
TREASURY FOR OASIA DOHNER  
USTR FOR STRATFORD/WINTER/ALTBACH

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SUBJECT: STRUCTURAL ISSUES WORKING GROUP AND TRADE REMEDIES WORKING  
GROUP DRAW COMPLAINTS ABOUT TRADE REMEDIES AND NON-MARKET ECONOMY  
STATUS

#### INTRODUCTION/SUMMARY

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11. (SBU) The Structural Issues Working Group (SIWG) convened on April 17, 2007, in Beijing and the Trade Remedies Working Group (TRWG) met on April 18, 2007. The SIWG was established in the April 2004 meeting of the U.S.-China Joint Commission on Commerce and Trade (JCCT) to provide a forum for the U.S. and Chinese governments to explore and discuss China's economy and its ongoing economic reform program, as well as issues concerning China's status as a non-market economy under the U.S. antidumping law. The TRWG, also established during the April 2004 JCCT meeting, provides a forum for both sides to raise issues of concern related to the others' trade remedy practices. Both working groups are co-chaired on the U.S. side by the Assistant Secretary for Import Administration at USDOC and the Assistant U.S. Trade Representative for China Affairs at USTR. The Director-General of the Bureau of Fair Trade for Import and Export at the Ministry of Commerce (MofCom) chairs the Chinese side for both working groups. (The last formal meeting of the SIWG and TRWG took place in May 2005, despite repeated USG efforts to schedule meetings since then.)

12. (SBU) In the April meetings, MofCom officials expressed dissatisfaction with recent U.S. trade enforcement actions, including the preliminary ruling in the countervailing duty (CVD) investigation of coated free sheet paper and the WTO challenges on IPR issues. They pressed for China to be granted market economy status, asserting that USDOC's previous determinations do not take into account the most recent reforms. Despite USDOC's extensive explanation of its analysis of China's non-market economy status, MofCom took the view that the U.S. has given China's state-owned enterprises insufficient recognition for independence from government directives and has not recognized the freer flow of labor in China, evidenced by the presence of 100 million migrant workers. Additionally discussed in the TRWG were other issues in antidumping cases between the two countries. END INTRODUCTION/SUMMARY

#### EXCHANGE WITH THE VICE MINISTER

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13. (SBU) MofCom Vice Minister Gao Hucheng made a brief appearance in which he underscored the importance of SIWG issues to advancing the Strategic Economic Dialogue (SED). Gao's tone was clear and serious, but also relatively relaxed and businesslike. He hoped that the SIWG would boost China's prospects for attaining market economy status and resolve bilateral differences over the recent U.S. trade enforcement actions, in particular citing USDOC's CVD

investigation of coated free sheet and USTR's IPR-related WTO challenges. Gao termed the March 30 CVD ruling a bad precedent; China is very unsatisfied, especially given that there also is an anti-dumping (AD) investigation in progress involving the same coated free sheet product. Although the amount of money involved is small, the CVD ruling could have a big impact, said Gao. Meanwhile, the U.S. Congress is sending negative signals on trade matters, creating uncertainty. Gao asserted the need for a better environment, with smooth and effective channels to resolve issues. Let's not politicize these matters, he said.

¶4. (SBU) Assistant Secretary David Spooner echoed Gao's hopes for a productive SIWG, explaining that the U.S. was in Beijing to "open its books" with regard to its August 30, 2006, decision not to grant China market economy status, including a detailed discussion of two important factors in the analysis: property rights and resource allocation. In addition, A/S Spooner explained that the U.S. side wanted to listen to the Chinese side's assessment of the August decision, especially concerning any incorrect information that may have been used in the evaluation of China's market. AUSTR Tim Stratford commented that China's transformation to a market economy is not fully complete and encouraged China to continue economic reform as such reform is good for not only U.S.-China trade relations but also overall Chinese economic and trade relations with the world.

#### REVIEW OF CHINA'S ECONOMIC REFORMS

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¶5. (SBU) Mofcom Bureau of Fair Trade for Import and Export Director General Li Ling reviewed China's economic liberalization since 1979, emphasizing the country's progress with regard to state-owned enterprise (SOE) reform. Many SOEs have been reorganized as joint stock corporations and a significant number of those have listed on stock markets domestically or abroad. Recent banking sector reform

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is particularly noteworthy, with the Bank of China and the Industrial and Commercial Bank of China having launched large and successful initial public offerings. The Agricultural Bank of China will organize as a joint stock corporation this year. Li also noted that China's banks increasingly have independently minded directors, not beholden to the government. She cited as an example the Bank of China's recent refusal to handle the return of questionable funds to North Korea as part of the Six-Party Talks.

¶6. (SBU) Li noted other areas of progress: a budgetary division between the government and the SOEs; a reduction of the government's role in enterprise decisions, except, notably, for land use and environment-related guidance; and an optimized foreign investment structure in sectors like banking and telecommunications. The Chinese Government has also backed the increased participation of labor in collective bargaining, particularly in industries with high concentrations of small- and medium-sized enterprises.

¶7. (SBU) Li listed a number of accomplishments in economic reform over the past year: the property law; the enterprise income tax law; the bankruptcy law; the partnership enterprise law; foreign bank management regulations; and other banking and supervisory regulations. Taken together, China is improving its market-based economic system and progress will continue, asserted DG Li.

#### DISSATISFACTION ON NON-MARKET ECONOMY STATUS

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¶8. (SBU) Following an introduction by A/S Spooner, Import Administration Office of Policy Director Ronald Lorentzen presented the findings of USDOC's review of China's non-market economy status in the recent lined-paper investigation. Lorentzen explained the review procedures, USDOC's reliance on expert, third-party data and information sources, and the fact-based, comprehensive nature of USDOC's analysis. Following a review of the six statutory factors, Lorentzen highlighted both the positive results of China's reform efforts to date -- including wage formation, foreign direct investment and the growth and development of the private sector -- and areas where additional reforms are needed, including property

rights, resource allocation and the banking sector. Lorentzen concluded by saying that while USDOC recognized in its analysis the many positive and impressive economic reforms that China has implemented to date, USDOC also found that the government retains considerable levers of control over the economy that precluded market economy status for China at the time.

¶9. (SBU) In response to Lorentzen's presentation, DG Li complained that the U.S.:

- o has large room for maneuver in making NME determinations;
- o provides inconsistent treatment across countries, making the process ambiguous;
- o has excessive discretion;
- o has a process that is not predictable or transparent; and
- o has drawn on information inconsistent with China's recent economic situation, choosing instead to focus on conditions that existed in previous decades.

¶10. (SBU) To illustrate her critiques, Li observed that China has in recent years gone to great lengths to free up the inter-regional movement of labor. Government statistics show that over 100 million rural migrants have found work in urban areas. Clearly, she said, these workers have choices and mobility. A/S Spooner assured DG Li that the United States strives to use well-respected and current data sources in conducting all non-market economy status reviews. He stressed that USDOC is as rigorous in its analysis and as consistent across cases as possible and takes into consideration all data and information and comments on the record, including any from the non-market economy country government. Spooner acknowledged the qualitative nature of the six factors and the flexible standard they provide, but emphasized the difficulty inherent in an analysis of change that is - building on a point Director General Li made earlier - continuous and unique to the country, time period and historical context in which it occurs. Cross-country comparisons are therefore difficult and possibly misleading. China's economy may compare well in some ways with countries that USDOC has graduated to market economy status, but China's economy is also very different in some ways from those countries. Spooner welcomed the feedback from the Chinese Government and again emphasized our interest in ensuring that we have accurate data.

#### PROPERTY RIGHTS AND RESOURCE ALLOCATION

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¶11. (SBU) USDOC Import Administration Senior Economist Albert Hsu discussed China's property law, commenting that entrepreneurs should be able to make independent, unrestricted business and investment decisions. He acknowledged progress, but indicated that more is needed, including that land use rights be portable. In response to comments from DG Li, Hsu said that designation, as a market economy does not require private land ownership; a system of well-defined, effectively enforced land-use rights will do. However, the August 2006 analysis concluded that China's system of land-use rights, particularly in rural areas, isn't quite there yet. A separate presentation by the Chinese side, using the auto industry as an example of resource allocation, triggered a discussion on markets and their self-correcting nature when they operate on a market basis. AUSTR Stratford pointed out that in a market economy, firms make investment decisions based on profitable returns, and when an industry is over-invested, investors move to under-invested industries, and in this way the market is self-correcting. Hsu pointed out that China's investment environment is not yet self-correcting, forcing China to use administrative measures to guide investment.

#### AUTOMOBILE SECTOR

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¶12. (SBU) In discussing the auto industry, AUSTR Stratford queried about consolidation. MofCom Bureau of Fair Trade Director for Export Division I, Liu Danyang, noted recent passage of the bankruptcy law. China's auto sector got off to a late start and has a short history, he said. The sector has become profitable over the

past 10 years, but now there are many players and much competition -- and local governments often see autos as a development pillar, leading to overcapacity and the driving down of profitability.

#### MARKET ORIENTED INDUSTRIES

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¶13. (SBU) DG Li asserted that USDOC's market-oriented industry (MOI) test was too difficult and asked questions about how applying CVD to a non-market economy would affect the antidumping side of the investigation. A/S Spooner listed several possible topics in that area for which USDOC would like to receive comments.

¶14. (SBU) DG Li said MOI analysis should be based on comparisons with other developing countries. She observed that no single industry in any NME has passed the MOI test, so this does not look feasible. Li asserted that just because an entity is an SOE, this does not mean its activities are not market driven. SOE business activities are not directed by the government, and USDOC has previously acknowledged this, she said.

#### TRADE REMEDIES WORKING GROUP

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¶15. (SBU) Both the Chinese and the U.S. sides raised concerns arising from antidumping cases between the two countries. DG Li again raised the CVD investigation on coated free sheet paper. The U.S. side took note of MofCom's comments and Lorentzen again encouraged MofCom to submit its comments on the administrative record of the case.

¶16. (SBU) DG Li also argued that separate rates and surrogate country selection were discriminatory. Lorentzen emphasized that the separate rates practice was designed to work to benefit Chinese producers and was developed in such a way as to balance fairness with administrative ease. He added that in this regard, USDOC had issued a Federal Register notice seeking comments on ways to improve separate rates practice and surrogate country selection, and encouraged MofCom to submit comments.

#### U.S. CONCERNS

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¶17. (SBU) Michael Rollin, Director of IA's Trade Remedy Compliance Staff, addressed concerns regarding transparency in China's antidumping practice and the issue of a U.S. company remaining subject to a Chinese antidumping measure after receiving a de minimis margin. Rollin also sought further information on MofCom's expiry (sunset) review procedures and its interactions with Chinese Customs in antidumping matters, providing a list of questions on

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relevant Chinese Customs procedures. DG Li assured Rollin that they would provide answers to the questions and additional information on expiry reviews through the IA office in Beijing.

#### NEXT STEPS

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¶18. (SBU) DG Li proposed that the next formal A/S-DG level working group meetings take place next year, with a sub-A/S planning meeting to precede it in the second half of 2007. While the USG is prepared to work closely with China on these issues, China's suggested timing of meetings and the continued lack of participation from Chinese expert agencies, such as the NDRC, limits our ability to work with China on a substantive level to build towards market economy status. The U.S. side has regularly requested participation by such experts in SIWG meetings, both at the formal and technical level, but MofCom has not included them on the Chinese delegations, generally citing as a reason its lack of jurisdiction over those agencies.

¶19. (SBU) Designated liaisons at USDOC and USTR will work with counterparts in MofCom to follow-up on open items from the April meetings and to organize the next SIWG/TRWG meetings.

